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Colo. ‘true lender’ settlement is path forward for bank-fintech partnerships

By Peter Weinstock, Marysia Laskowski and Eric W. Flynn
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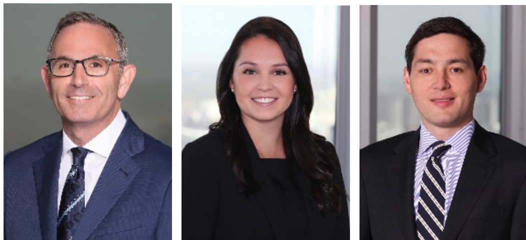

A landmark settlement that Colorado authorities recently reached with two marketplace lenders and their bank partners has created a much clearer framework in determining who is a true lender for the life of a loan in fintech-bank partnerships.

The settlement involving the Colorado attorney general and the administrator of the Colorado Uniform Consumer Credit Code might only apply to the lenders involved but the framework addresses years of legal battles over who is a true lender when the loan is transferred through multiple parties — a question that has intensified as more banks partner with online lenders.

The framework created through this settlement also establishes a responsible bank-partnership model for fintech digital lending programs that will ultimately help offer access to affordable credit nationwide. And the timing has never been more critical as more consumers struggle financially in the economic downturn triggered by the coronavirus pandemic.

Furthermore, the settlement’s responsible bank-partnership model is good timing because federal and state financial regulators have openly confronted each other regarding jurisdiction over fintech relationships in a flurry of rules and litigation.

For example, the Office of the Comptroller of the Currency in May adopted a long-awaited final rule allowing banks to workaround a 2015 court decision (known as the Madden v. Midland case) that limited banks’ ability to sell loans. That ruling unwound the so-called “valid when made” doctrine, which allowed the interest rate originally written on the loan to carry for the life of the loan even if it’s sold. The OCC’s new rule seeks to clarify that a loan's interest rate can remain legally intact even after the loan is acquired by a purchaser in a state with a lower rate cap. Shortly after the OCC’s rule, the Federal Deposit Insurance Corp. followed suit and issued a nearly identical rule in June, both of which drew immediate attack from state regulators.

The OCC again sought to bring clarity to the fintech industry, proposing a rule in July that would determine the identity of the “true lender” in a fintech-bank relationship based on the entity listed as the lender on the loan agreement or the entity funding the loan at the time of origination.

Just two months after the OCC finalized its valid-when-made rule, the attorneys general of California, Illinois and New York brought suit against the OCC claiming the rule as “arbitrary and capricious,” attacking it from multiple angles and decrying the lack of consumer protection.

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The sudden salvos of rules and litigation clearly delineate the battlelines, pitting industry participants, and state and federal regulators.

Against this backdrop is the recent settlement by Colorado regulators with two of the largest fintechs, banks acting as trustees and two prominent platform banks in the fintech industry. The detailed agreement can be distilled down to one formula: Banks and fintechs that structure their relationship in compliance with five criteria will find a regulatory safe harbor.

Those five criteria are: bank oversight of the fintech; certain consumer loan terms; fintech licensing requirements (including annual compliance reports); disclosure of the bank's role to consumers; and perhaps most significantly, four permissible structures with respect to the sale of loans originated by the bank in connection with fintech relationships. This structure will likely be closely monitored throughout the industry and become a model in other states as well.

The settlement appears to be a grand compromise following three years of litigation, perhaps providing a middle ground for the aforementioned warring parties between federal and state regulators.

The settlement provides clarity on key issues, including an interest rate cap at 36% and funding limits on loans originated as part of the fintech-bank relationship. It also enumerates top oversight mechanisms that banks must undertake over fintechs and mandating licensing for fintechs taking assignment of certain types of loans.

The provisions also continue to allow any Colorado efforts designed to protect borrowers from what regulators consider high-interest, predatory lending products that perpetuate cycles of debt. The settlement also breaks new ground in the regulation of private contracts to sell loans originated by banks in the fintech relationship to fintechs, securitizations and/or third parties.

No other case, regulation or rule has addressed the loan purchase process and, in doing so, the settlement represents a pioneering effort to regulate the economic engine that drives the bank-fintech lending industry.

To be clear, the settlement agreement does not, nor could it, address every facet of the complicated loan purchasing process. However, the agreement sets forth certain transactional pillars related to the types of loans that can be sold, how it can be sold and the percentages of loans that can be transferred (within the safe harbor).

There will likely be many questions on just how loan purchase agreements can be molded to fit within the prescribed constructs, and whether the agreements even need to do so. But what's clear from the settlement is that the sophisticated parties that negotiated the agreement put careful thought into its terms so as not to be overly disruptive to the vital loan-purchase process.

Overall, the settlement agreement offers a checklist approach to when a financial institution's involvement is sufficient so that a subsequent loan buyer does not need to worry about state-usury defenses. It also provides helpful guidance to industry participants seeking to navigate the current vacuum created when the Dodd-Frank Act changed the preemption rules.

Rather than fight out the issue in further court and state enforcement initiatives with federal regulators weighing in, at least the parties in Colorado have chosen to find areas for compromise.

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Editor's Note: Hunton Andrews Kurth LLP represents Cross River Bank, but not as counsel in the Colorado litigation.

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